THE NATIONAL CITY BANK OF NEW YORK

1951

# Monthly Letter on Economic Conditions Government Finance



New York, May, 1951

## General Business Conditions

THE quieting of demand and the check to the price rise during the past two months have made a considerable impression on business sentiment, but it would be hard to show that they have had any substantial effects on production and employment or that they have altered the overall outlook to a major extent. Industrial activity holds at or close to the peak reached in March, when the Federal Reserve Board's production index set a new peacetime record at 223 (1935-39 = 100). Employment figures are correspondingly high. The manufacturing industries at the end of March had unfilled orders of $51.4 billion, according to Department of Commerce figures, compared with $21.8 billion a year ago.

With backlogs of this size, and armament orders to be placed at an accelerated rate, the industrial outlook obviously is strong. In his message to Congress April 26, asking for revision and extension of the Defense Production Act, President Truman said the Government has placed orders for equipment, facilities and supplies totalling over $26 billion since June 1950. He added that over $58 billion more in orders are to be placed before the end of June 1952. It will be many months before production of finished arms reaches heavy volume, but actual defense outlays are now at the rate of nearly $30 billion annually, and meanwhile plant construction, tooling up, and hiring and training of workers proceed.

These figures point up the fact that, while the consumers' goods boom has slowed down, the capital goods boom, derived from plant and equipment expenditures, heavy construction and defense orders, is unchecked. Fluctuations in business investment, comprising capital goods expenditures and inventories, are the most common causes of overall business fluctuations in a modern industrial society. It would be hard to predict the nature and extent of inventory changes in the months to come, but the current rate of investment in plant and equipment plainly has some time to run.

### *Consumers' Goods Overstocked*

In some lines of consumers' goods the evidence is clear that markets are saturated, merchants are overstocked and overcommitted, and business has been borrowed from the future. The attitude of buyers both at retail and wholesale has changed. For a time people were thinking only of shortages and inflated demand. Now they have begun to think also of the immense productive power of this country, and of the letdown that according to experience often follows anticipatory buying and inventory buildup. Retailers are finding it necessary to put on promotions to stimulate sales. They are allowing commitments to decline, which reduces activity in wholesale markets.

Automobile sales show hesitation, and used car prices have been easy during April, a month in which seasonal influences should keep them strong. Building statistics suggest that residen-

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tial construction has passed its peak, certainly after seasonal adjustment of the figures and perhaps in absolute terms; for housing starts in March were lower than in March last year, and early figures on April residential contracts were below a year ago.

It is interesting to note that what seems to be feared now is not, in the main, a "conversion recession", meaning a drop caused by the shift of materials and labor from normal use to defense work. This necessary shift might leave pools of unemployed people and facilities not readily transferrable to arms production, and last fall the danger of a decline due to these frictions was much discussed. The current anxiety, however, is that demand, in an inevitable reaction from the boom, may fall short of production, and that the effect on the general situation may be intensified by a change from stocking up to liquidation, with possible accompanying losses.

Any upsurge of consumer and mercantile buying on the scale that the country has seen twice since last June must be expected to bring reaction to correct overstocking and overcommitments. The extent of the reaction, however, will necessarily be influenced by underlying conditions as to employment and buying power. While people have work at high wages they will not continuously abstain from buying, and corrective liquidation can be spread over time and proceed in an orderly way. This is the significance, for the general situation, of the assured activity in the heavy industries and of the accelerating defense expenditures to come. Merchants can look ahead as well as other people and their inventory policy will be influenced accordingly.

Manufacturers' inventories have aroused less concern than mercantile stocks, although they reached another new peak of $36.6 billion at the end of March. Against these inventories, manufacturers had unfilled orders approximately half as large again, as the figures given in the first paragraph of this Letter show. A year earlier inventories exceeded unfilled orders by approximately a third.

### *An Official Forecast*

President Truman's message to Congress on April 26 includes what is in effect an official business forecast. He said that "tax, credit and price and wage control actions have taken hold". He noted that production has increased substantially, the buying wave has — at least for the time being — died down, and the upward rush of prices has been checked. He went on to say, "We are now having something of a breathing spell. But it will not last. This fall and winter the economy will be hit by the full impact of military production."

Doubtless the President and his economic advisers would not expect agreement with this analysis in every detail. Business men find, for example, more causes for the "breathing spell" than the message enumerates; and some will have reservations as to the time when the "full impact" of military production will be felt, because of the machine tool bottleneck which retards equipment of plants. In broad outline, however, the forecast accords with the probabilities as many others see them. As growing defense expenditures add to the pressure on materials, labor and productive facilities, the problem is not likely to be a deficit of purchasing power relative to civilian goods, but an excess.

The need now is to turn the breathing spell to advantage, and to prevent inflationary forces from obtaining a toehold again. The essence of the danger is that capital investment plus defense expenditures threaten to exceed the tax take plus the savings of the country — in short, that more will be undertaken than the country can produce. Influential steps, notably the Federal Reserve policy which during the past six weeks has tightened credit significantly, have been taken. On other fronts the defenses thus far are less effective. Government economy and higher taxes are needed to balance the budget in fiscal 1952, and the taxes should discourage spending rather than saving and investment.

To restrain the capital expenditures which Federal and local governments, corporations and people wish to make, and keep them within the limits of the supply of materials and labor, the Government has a direct weapon, namely, the power to grant or deny scarce materials such as structural steel for specific projects. These powers should be used rigorously, for in no other way can restraint be exercised so simply and effectively. The responsibility for using them, resting in the National Production Authority, is in the best possible hands. Another area which needs, and is receiving, reexamination is the stockpiling program, which has been carried to the extreme of depriving allied countries of materials wanted for their own armament effort and at the same time forcing up prices beyond reason.

Measures of this kind need to be supplemented by credit and fiscal policy. All restrictions are unwelcome to someone, but restraint

in nondefense capital expenditures, particularly of the luxury or mere convenience type, should have the fullest possible support. The alternative is rigorous price and wage controls, with their inherent weaknesses and inequities, which put the economy in a straightjacket.

## First Quarter Earnings

Reports for the first quarter issued last month by several hundred corporations show that in practically every case the dollar volume of business increased substantially over the first quarter of a year ago, before the Korean outbreak and the resulting boom in activity and prices. The expansion in revenues was heavily offset by sharp increases in taxes, labor and material costs, and other operating expenses. Nevertheless, net income after taxes increased for a majority of the early reporting corporations.

Our tabulation of the figures now available for 550 corporations, representative mainly of the larger manufacturing enterprises but including also a limited number in the mining, trade, and service industries, shows a combined total of net income after taxes of approximately $1,318 million in the first quarter. This is 30 per cent above the total in the first quarter of 1950 — before Korea — and about three out of every four individual companies showed increases.

As compared with the fourth quarter of 1950, however, net income was 14 per cent lower, and about two out of three companies showed decreases. Net income this year was, in fact, considerably lower than in either the third or fourth quarter of 1950, as may be seen from the following quarterly totals:

| | | |
|---|---|---|
| 1950 | First quarter | $1,014,000,000 |
| | Second quarter | 1,289,000,000 |
| | Third quarter | 1,480,000,000 |
| | Fourth quarter | 1,539,000,000 |
| 1951 | First quarter | 1,318,000,000 |

The summary at the bottom of the page reveals the highly uneven changes among different industrial groups. Those showing sizeable increases over a year ago include beverages, textiles, pulp and paper, chemicals, petroleum refining, building equipment, and various metal products — although within these groups numerous decreases occurred.

### *Manufacturers' Costs and Taxes*

For many companies the increased business volume to capacity operation was accompanied by shrinkage in the profit margin on sales. This may be seen from a comparison of the relative changes in net income and in sales of 100 large manufacturing corporations reporting sales figures. The following condensed table gives comparative income data for the first quarter of the two years:

**Sales and Net Income of 100 Large Manufacturing Corporations in the First Quarters of 1950 and 1951**

(In Millions of Dollars)

| | 1950 | 1951 | Change | % Change |
|---|---|---|---|---|
| Sales, etc., revenues | $6,912 | $9,436 | +$2,524 | + 37 |
| Total costs, except taxes | 6,026 | 7,865 | + 1,839 | + 31 |
| Income before taxes | 886 | 1,571 | + 685 | + 77 |
| Fed. income & e.p. taxes | 345 | 930 | + 585 | +170 |
| Net income after taxes | $ 541 | $ 641 | + 100 | + 18 |
| Taxes to income before taxes | 39% | 59% | | |
| Net income per sales dollar | 7.8c | 6.8c | | |

**NET INCOME OF LEADING CORPORATIONS FOR THE FIRST QUARTER**

(In Thousands of Dollars)

| No. of Cos. | Industry Groups | Reported Net Income After Taxes: First Qr. 1950 | Fourth Qr. 1950 | First Qr. 1951 | Per Cent Change From: First Qr. 1950 | Fourth Qr. 1950 |
|---|---|---|---|---|---|---|
| 29 | Food products | $ 29,278 | $ 41,782 | $ 31,790 | + 9 | —24 |
| 15 | Beverages | 16,236 | 30,286 | 29,992 | +85 | — 1 |
| 9 | Tobacco products | 16,769 | 20,953 | 17,320 | + 3 | —17 |
| 29 | Textiles and apparel | 21,102 | 27,520 | 26,557 | +26 | — 3 |
| 24 | Pulp and paper products | 18,948 | 35,319 | 34,002 | +79 | — 4 |
| 40 | Chemicals, paints, etc. | 144,475 | 194,289 | 168,469 | +17 | —13 |
| 15 | Drugs, soap, cosmetics | 28,460 | 28,150 | 34,279 | +20 | +22 |
| 23 | Petroleum products | 251,305 | 429,151 | 377,358 | +50 | —12 |
| 24 | Cement, glass, and stone | 39,413 | 45,976 | 45,486 | +15 | — 1 |
| 38 | Iron and steel | 160,808 | 168,402 | 176,218 | +10 | + 5 |
| 18 | Building, heating, plumbing equipment | 10,736 | 25,838 | 16,318 | +52 | —37 |
| 18 | Electrical equipment, radio and television | 60,882 | 106,738 | 65,871 | + 8 | —38 |
| 40 | Machinery | 25,239 | 32,957 | 30,314 | +20 | — 8 |
| 11 | Office equipment | 12,765 | 19,387 | 13,991 | +10 | —28 |
| 40 | Automobiles and parts | 45,577 | 50,379 | 48,388 | + 6 | — 4 |
| 12 | Railway equipment | 6,523 | 17,998 | 12,742 | +95 | —29 |
| 9 | Aircraft and parts | 10,371 | 18,787 | 11,898 | +15 | —37 |
| 58 | Other metal products | 40,981 | 94,554 | 75,777 | +85 | —20 |
| 27 | Miscellaneous manufacturing | 14,533 | 27,320 | 23,830 | +64 | —13 |
| 479 | Total manufacturing | 954,401 | 1,415,786 | 1,240,595 | +30 | —12 |
| 32 | Mining and quarrying* | 26,441 | 56,025 | 38,312 | +45 | —32 |
| 22 | Trade (retail and wholesale) | 19,415 | 49,238 | 26,934 | +39 | —45 |
| 17 | Service and amusement industries | 14,113 | 17,588 | 11,768 | —17 | —33 |
| 550 | Total | $1,014,370 | $1,538,632 | $1,317,604 | +30 | —14 |

* Net income is reported before depletion charges in some cases.

It will be seen that revenues from sales and other sources aggregated approximately $9,436 million, an increase of $2,524 million or 37 per cent over the first quarter of a year ago.

Total costs for labor, materials, and all other expenses, except federal income taxes, amounted to $7,865 million, an increase of $1,839 million or 31 per cent.

Income of $1,571 million before taxes was up $685 million or 77 per cent.

Liability for federal income and excess profits taxes jumped from $345 million to $930 million, or by 170 per cent. Whereas such taxes took an average of 39 per cent of operating income in the first quarter of 1950, they took 59 per cent this year — equal to ten cents out of every sales dollar. Present rates are 47 per cent for the normal tax and surtax, plus 30 per cent on those earnings defined by law as "excess profits". Of the latter, the government thus takes over three-quarters.

Net income after taxes of $641 million increased only $100 million or 18 per cent. Since net income increased less than gross income, the average profit margin for the group was narrowed, as shown in the table, from 7.8 to 6.8 cents per sales dollar. On the increment of $2,524 million in additional sales, the average profit margin was only 4.0 cents per sales dollar.

These figures reveal how the tremendous expansion that took place in the dollar volume of sales permitted manufacturers generally to offset the persistent rise in production costs, which otherwise would have squeezed profit margins much more, or wiped them out entirely. The relatively high earnings, in turn, continued to be the major source of funds for financing the further expansion made this year in plant and equipment.

A number of corporate executives at annual shareholders' meetings held last month called attention to the less favorable earnings comparisons that may be expected as a result of the curtailment from boom levels now taking place in civilian goods production and the conversion to military orders. Industrial costs have risen so materially during recent years that even a moderate recession in volume might bring about an unusually sharp cut in net earnings and in available funds.

## The Bond Market

April saw the further effective development of the Treasury-Federal Reserve "Accord" which had been announced March 3 and followed by successive withdrawals of Federal Reserve price supports under the government bond market. One part of the "Accord" was the decision to give holders of the $19.7 billion Seventh War Loan and Victory War Loan 2½s, both issues of restricted marketability, the opportunity to convert their bonds into a new type of 24-29 year nonmarketable 2¾s. Since the two issues of 2½s mature in June and December of 1972, an additional return of ¼ per cent was offered to the holder who would accept a 7½ or 8 year extension of maturity. The new bonds carry no cash redemption privilege prior to maturity, though they may be exchanged at any time over their life for 1½ per cent five-year Treasury notes of the regular marketable type.

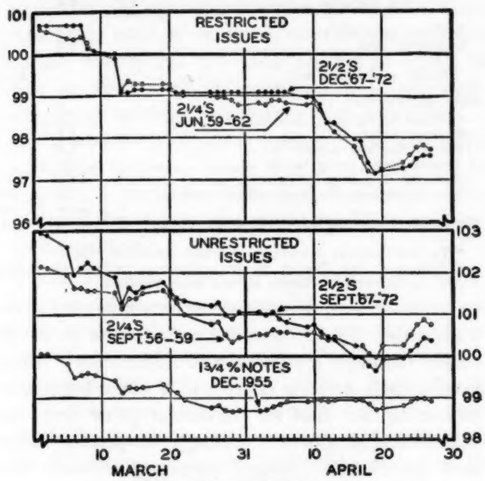
Subscription books on the conversion were opened for a two week's period, March 26 to April 6. On April 13 the Secretary of the Treasury was able to announce that public subscriptions reached $8 billion. Officials previously had indicated that they would consider a $4 or $5 billion conversion very good. Life insurance companies alone converted more than $2½ billion. Apart from $8 billion of public subscriptions, the Federal Reserve Banks and Treasury investment accounts converted $5.6 billion of the 2½s, bringing the total new issue of nonmarketable 2¾s beyond $13½ billion. There remain outstanding, unconverted, only $2 billion of the Seventh War Loan and a little over $4 billion of the Victory Loan.

The new, nonmarketable 2¾s represent the longest term government securities presently outstanding and also the largest single issue. The hope and reasonable expectation is that, barring emergencies, they will be put away by their holders for keeps. In any event, an immediate object was achieved of decisively cutting down the volume of 2½s that might be put on the market for sale, and making the transition to a freer market more manageable and orderly.

### *Bond Price Movements*

During the period the books were open for exchange subscriptions, March 26 to April 6, the Federal Reserve Banks provided support at 99 1/16 for the two issues involved. Selling pressure was continuous from holders pressed for cash to cover investment commitments or apprehensive of further price decline. Many speculative holdings, acquired on the assumption that par pegs would be held and that the only way prices could go was up, were also liquidated in this period. After the conversion was completed, the Federal Reserve found means to discourage selling by backing away from the market. Over a period of nine trading days, April

9-19, prices of the unconverted Seventh War Loan and Victory Loan were permitted to decline from 99 1/16 to 97⅛. Other bonds in the restricted class, both 2½s and 2¼s, followed a similar pattern under similar influences and closed on April 19 in the range of 97 to 98. At this point buying came into the market, selling subsided, and there was a brisk rally.




**Daily Closing Bid Quotations**
**Selected Government Security Issues**

The accompanying chart shows daily price movements for March and April of five selected government security issues, two of the restricted type and three unrestricted. The longest-term unrestricted bond, the 2½s of September, 1967-72, which went from 103 to 101 during March, traded as low as 99⅝ on April 19. The 2¼s of September 1956-59, which commanded a premium of 2 points at the beginning of March and one of ½ point at the end, briefly dipped below par on the 19th. Bonds and notes maturing within five years showed only moderate fluctuations. The several issues of 2s, all due in the next few years, held close to par. The 1¾ per cent notes due in December 1955, and other issues of intermediate term, ended April higher than they had started out at the beginning of the month.

As the following table shows, the Federal Reserve Banks bought $334 million government securities in the four weeks ended April 25 compared with $725 million in four weeks of March. The main purchases were long-term restricted 2½s acquired up to April 6 when books were closed on the conversion offer. The authorities allowed these purchases to build up surplus funds in the money market which helped satisfy desires among investors for better liquidity, discouraged panicky selling, and gave aid to the restabilization of the long-term market. The surplus funds increased demands for Treasury bills and notes maturing later this year. The Federal Reserve supplied moderate amounts of these securities to the market.

**Federal Reserve Open Market Operations**
**(In Millions of Dollars)**

| | Holdings Feb. 28 1951 | Holdings Mar. 28 1951 | Holdings Apr. 25 1951 | Monthly Changes Mar. 28 1951 | Monthly Changes Apr. 25 1951 |
|---|---|---|---|---|---|
| Bills | 1,527 | 1,599 | 1,425 | + 72 | —174 |
| Notes | 14,961 | 14,974 | 14,945 | + 13 | — 29 |
| Bonds*: | | | | | |
| 0—5 yrs. | 1,579 | 1,602 | 1,679 | + 23 | + 77 |
| 5—10 yrs. | 987 | 1,030 | 1,032 | + 43 | + 2 |
| Over 10 yrs. | 2,827 | 3,401 | 3,859 | +574 | +458 |
| Total | 21,881 | 22,606 | 22,940 | +725 | +334 |

* Classification based on maturity or first optional call date.

While short-term money rates were generally unchanged during April, yields on long-term bonds of all types showed increases ranging up to ⅛ per cent:

**Bond Yields**

| | March 2 | March 30 | April 30 |
|---|---|---|---|
| Unrestricted U. S. Governments | | | |
| 1¾s, Dec. 1955 (notes) | 1.78% | 2.01% | 1.99% |
| 2¼s, Sept. 1956-59 | 1.83 | 2.14 | 2.09 |
| 2½s, Sept. 1967-72 | 2.28 | 2.41 | 2.47 |
| Restricted U. S. Governments | | | |
| 2¼s, June 1959-62 | 2.17 | 2.36 | 2.49 |
| 2½s, Dec. 1967-72 | 2.44 | 2.55 | 2.65 |
| Corporate and Municipal | | | |
| AAA corporate bonds* | 2.69 | 2.85 | 2.88 |
| Baa corporate bonds* | 3.18 | 3.28 | 3.38 |
| High grade municipal bonds† | 1.65 | 1.94 | 2.08 |

* Moody's Investors Service. † Standard & Poor's Corporation.

### *Financing Ahead*

With the passage of time attention naturally is shifting to the concentration of marketable debt maturities which the Treasury has coming up from June 15 through December 15, and which will have to be taken care of by the offer of new securities in exchange. This has been referred to as a $52 billion problem, but $13 billion of the total is made up of weekly issues of Treasury bills. Bills have been in good demand and constitute no real problem. Even the balance of $39 billion, in notes and bonds, is an overstatement of the refunding problem as the makeup of the amount suggests.

As the next table shows, Federal Reserve Banks and Treasury investment accounts jointly hold $12 billion of the securities involved. These presumably will be exchanged for whatever the Treasury offers. Moreover, of the public holdings of $27 billion, only $17 billion definitely falls due this year. The other $10 billion is represented by the public holdings of bonds which are callable at the option of the Treasury, mainly fully taxable 2 per cents. They can be left outstanding, according to their terms, for some years longer if the Treasury should so elect. The hard core of the problem is thus under $20 billion.

**1951 Treasury Refunding Schedule**
(In Millions of Dollars)

| | Total Outstanding | Government Investment Accts. & F.R. Banks | Held by General Public |
|---|---|---|---|
| **Fixed Maturities:** | | | |
| 2¾% bonds called June 15* | $ 1,627 | $ 1 | $ 1,626 |
| 1¼% notes due July 1 | 8,445 | 1,716 | 6,729 |
| 1¼% notes due Aug. 1 | 5,351 | 1,761 | 3,590 |
| 1¼% notes due Oct. 1 | 1,918 | 14 | 1,904 |
| 1¼% notes due Oct. 15 | 5,941 | 4,676 | 1,265 |
| 1⅛% notes due Nov. 1 | 5,253 | 3,377 | 1,876 |
| Fixed Maturity Subtotal | $28,535 | $11,545 | $16,990 |
| **Redeemable at Treasury's Option:** | | | |
| 2 % bonds callable Sept. 15 | 7,986 | 625 | 7,361 |
| 3 % bonds callable Sept. 15* | 755 | † | 755 |
| 2¼% bonds callable Dec. 15* | 1,118 | † | 1,118 |
| 2 % bonds callable Dec. 15 | 510 | 7 | 503 |
| Grand Total | $38,904 | $12,177 | $26,727 |

* Partially tax exempt. † Less than $500,000.

Source: U.S. Treasury Bulletin. Distribution of holdings is as of January 31, 1951, but there has been no change of major significance since that time.

**Public Debt Transactions and Treasury Cash Position July 1, 1950 to April 24, 1951**
(In Billions of Dollars)

| | | | |
|---|---|---|---|
| Cash balance on June 30, 1950 | | | $ 5.5 |
| Budget surplus, 7/1/50 to 4/24/51 | | | 4.4 |
| Borrowings: | | | |
| Direct from gvt. agencies and trust funds | | $2.2 | |
| Savings bonds: | | | |
| Special sales* | $0.9 | | |
| Regular sales | 3.6 | | |
| Accrued discount | 0.8 | 5.3 | |
| Savings note sales | | 2.3 | |
| Treasury bills | | 0.1 | 9.9 |
| Gross available funds | | | $19.8 |
| Debt retirements: | | | |
| Savings bonds | | 5.1 | |
| Savings notes | | 2.7 | |
| Postal Savings notes† | | 1.0 | |
| Armed forces leave bonds | | 0.1 | |
| Matured Treasury certificates | | 2.2 | |
| Treasury bonds due or called for payment | | 1.5 | 12.6 |
| Cash balance on April 24, 1951 | | | $ 7.2 |

* To institutional investors, October-December, 1950.
† Redeemed for Postal Savings System mainly to provide funds for purchasing bonds in the open market.

The Treasury has most immediately ahead the problem of deciding what to offer holders of bonds and notes maturing on June 15, July 1, and August 1, in order to obtain favorable exchange percentages. Public holdings of these amount to $12 billion, mostly in the hands of corporations, banks, and foreign governments, to whom they represent secondary cash reserves. One obvious choice is to offer short-term paper designed to meet demands of this type.

Aside from forthcoming exchange offerings, the Treasury faces a period of deficit operations from July through December which will require some new money borrowings. The immediate cash position is strong. The record flow of tax revenues in the early months of this year gave the Treasury on April 24 a cash balance of $7.2 billion. As the accompanying table brings out, this is an improvement of $1.7 billion since June 30, 1950 despite a reduction in the meantime of $2.7 billion in the public debt. If there is some restraint in government spending, the major needs to borrow later this year will be to find funds to pay off Savings bonds, Savings notes, marketable notes presented for payment at maturity, and bonds that may be called for retirement.

### *Effects on Credit Supply*

While interest rates remain very low, by any historical standard, borrowers and lenders are aware that money is less easy to get than it was only a few weeks ago. The key to this wholesome change lies in the bond market drop which was allowed to go considerably further than almost anyone had anticipated.

Many people had assumed that the guaranteed prices of par or better would be good forever, or, if not, that a fixed floor fractionally under par would be established. Although the authorities put up a resistance to the price decline, through purchases at successively lower levels, their actions conveyed a clear impression to the market that no particular price level was considered important enough to justify unlimited purchases. Heavy offerings found them ready to give ground and this led sellers either to withdraw their offerings or to look for outside buyers, tempted by the improved yields, to take them up.

All the signs were that the authorities wanted to get out of the business of manipulating and supporting the long-term bond market. The holder of marketable government bonds has been rather forcibly reminded that the Treasury promises no more than payment of interest and principal when due and that the obligation he holds contains no guarantee against adverse price fluctuations. There is increased caution abroad, not only among lenders but also among borrowers conscious of the more selective attitude on the part of the lender. The dollar in hand is held in higher esteem because the borrowed dollar does not come so easy. The savings institution is using less effort to hunt out profitable new outlets for funds and more effort to attract new funds. This is all to the good in a time of inflation.

### *Voluntary Credit Restraint Program*

The Voluntary Credit Restraint Program, fortuitously, was officially launched March 9 during the course of the bond price unpegging. It provides guides to financing institutions on where, in the broader public interest, credit should be withheld. Two points of special em-

phasis in the program thus far have been credits to carry inventories beyond reasonable amounts, and credits for capital expenditure. On inventory loans, the recent slowing in retail demand has usefully reinforced the caution of both lenders and borrowers.

On loans for expansion, the need is to cut back the $24 billion which business has expected to spend during 1951 for new productive facilities. This total, if realized, would be nearly one-fourth above the previous record of $19.2 billion in 1948, and in excess of the prospective supply of savings, corporate and individual. If we are to avoid further inflation the $24 billion will have to come down, and by cutting out less important projects. Likewise, the large outlays planned by States and municipalities will have to be pruned.

The responsibility for accomplishing such a cutback is shared not only by private borrowers and lenders, but also by government agencies which are concerned with allocating materials or are participants in the lending business. We will not have credit restraint if government lending and loan-guaranteeing agencies spring to the rescue of every marginal enterprise that encounters difficulties of financing.

The bond unpegging, and the Voluntary Credit Restraint Program, take time to work and to show effects in credit statistics. It takes time to reappraise lines of credit, and weeks and sometimes months to work off forward commitments. Moreover, the power of demand for credit, amplified by rising prices and expectations of still higher prices, is not to be underestimated. As a levelling trend in weekly bank loan figures suggests, the momentum of credit growth has been checked for the present. The longer term result rests in the area of government expenditures, discussed in the following article, and in the area of capital expenditure. Without wise policies in those areas it will be difficult indeed to keep the volume of bank credit stable.

## Revised Budget Outlook

Revised estimates by Secretary Snyder of Treasury receipts and expenditures for the fiscal years 1951 and 1952, and a new estimate by the Congressional staff of tax experts headed by Colin F. Stam, both published last month, indicate a welcome change in the fiscal outlook.

Secretary Snyder, in his statement to the House Ways and Means Committee on April 2, disclosed that the Treasury now expects to end the current fiscal year on June 30 with a surplus of around $3 billion, instead of the deficit of $2.7 billion predicted in the January budget. Including social security taxes treated as trust fund transactions, the Secretary's estimate indicates that the Treasury may end this year with an overall cash surplus of possibly $5 billion.

The shift of $5.6 billion for the better in the Treasury estimate of ordinary budget receipts and expenditures within a few months reflects changes on both sides of the ledger. On the revenue side March receipts proved to be much larger than had been estimated and indicated that total receipts for this full fiscal year might be about $2.7 billion better than forecast. This, Mr. Snyder explained, was due primarily to unexpectedly heavy receipts of individual and corporate income taxes, plus excise taxes, swelled by the wave of scare buying following the Korean outbreak.

On the expenditure side, the Treasury estimate for this fiscal year has now been lowered by $2.9 billion. This reflects partly a lag, as many people anticipated, in the rise of military disbursements and partly the sharp economic upturn, making possible reductions in certain civilian programs, including outlays for farm price support and for veterans' aid.

As to the fiscal year 1952, the Secretary stated that "in the absence of unexpected developments" revenues are now estimated at about $3 billion higher than previously. No revised figures were given as to expenditures in fiscal '52, but if these are unchanged, the revenue increase would cut the budget deficit from the $16.5 billion originally forecast to $13.1 billion.

Later in the month the Congressional tax experts issued a report containing estimates of receipts that were even higher, amounting for fiscal '51 to $47.8 billion and for '52 to $60.9 billion. On this basis the surplus for '51 would be raised to $3.5 billion, while the deficit for '52 would be cut to $10.7 billion.

The following table compares the original budget estimates for 1951 and 1952 with the Treasury's latest estimates and those of the Congressional tax experts:

**U. S. Budget Estimates for the Fiscal Years 1951 and 1952**

**(In Billions of Dollars)**

| | January Budget | April Revision | Stam Estimate |
|---|---|---|---|
| **Fiscal 1951** | | | |
| Total expenditures | $47.2 | $44.3 | $44.3 |
| Total receipts | 44.5 | 47.2 | 47.8 |
| Surplus or deficit | —2.7 | 2.9 | 3.5 |
| **Fiscal 1952** | | | |
| Total expenditures | 71.6 | 71.6 | 71.6 |
| Total receipts | 55.1 | 58.5 | 60.9 |
| Surplus or deficit | —16.5 | —13.1 | —10.7 |

In the light of the improvement in the budget outlook, Secretary Snyder expressed the Administration's willingness to scale down from $16.5 to $10 billion the tax increases that had been asked for this year.

### *No Basis for Complacency*

It goes without saying that this brightening in Treasury prospects, while gratifying, affords no basis for complacency. A deficit of $10 billion is still an enormous figure. Moreover, satisfaction in the indicated betterment must be tempered by realization that a good part of the increased revenue yield is attributable to inflation; and this of course is the very condition we are trying to avoid. Considering the fact that what we probably face is not a relatively short, all-out war effort, but a period of partial mobilization that may last for years, there is no excuse for running a deficit at all. We should pay the defense bill as we go along.

Thus the real question comes back to deciding on *how* we are going to balance the budget – whether by postponing or foregoing programs and projects that we could do without, or by loading on more taxes. If, as Secretary Snyder says, we face a deficit of $10 billion, a cut in expenditures of $3 billion would reduce the new taxes required to $7 billion. If spending were cut $5 billion, the required tax increase would be $5 billion.

### *Congressional Economy Moves*

Recent reactions by Congress to spending proposals appear to indicate a stronger sentiment for cutting expenditures. The House of Representatives last month approved the $6.4 billion supplemental appropriations requested for the armed forces for the balance of this fiscal year, but shaved $4.5 million from the $46.8 million additional requested for the Atomic Energy Commission. It voted a 43 per cent slash in the $843 million supplemental appropriations for various other agencies, including a 90 per cent cut in the $97 million sought by the State Department for expansion of the "Voice of America" program. The House Appropriations Committee indicated its support for the aims of this program, but criticized the operation severely on the grounds of mismanagement and poor planning. It recommended that the State Department come back with "a more intelligent" and "better planned program."

The House also cut by more than 50 per cent the $403 million asked for the civil defense program. Its Committee charged that the plans still appeared to be of a "nebulous" nature and coordinated "only slightly" with those of the military forces.

The appropriation sought for a decentralization of federal agencies was disallowed, the Committee suggesting that definite planning precede grant of funds.

A $51 million request for administrative funds for defense production agencies and activities was cut to $38 million. The Committee recommended absorption of new duties by older agencies.

On April 30 the Senate Appropriations Committee concurred with the House in the sharp cut in the funds requested for the "Voice of America" and made additional cuts in the supplementary appropriations for the civil defense program.

In a sharply worded criticism of government agency spending habits in general, the House Appropriations Committee charged that although "this nation has been in an emergency since the end of the war," nevertheless "all agencies of the government resumed business as usual, disregarding the varied and continued threats to our security." The executive branch itself is not willing to assume the sacrifices it is asking the rest of the nation to make, the Committee charged. "All agencies, it seems, are willing to assist in the defense effort provided they can continue to carry on their regular activities."

(The House Post Office and Civil Service Committee, in a report rendered January 1 on an investigation of employee utilization in the executive departments and agencies, criticized severely many departmental operations and found that, in general, "executive agencies could do a better job with fewer employes . . . work habits are relaxed . . . improved methods and labor-saving techniques have not been placed in general practice . . . overhead administrative costs have increased sharply . . . little or no control is exercised from within to enforce economies." It revealed that "unofficially, some of the key budget officers confide that they would welcome the opportunity to reduce the budget requirements within their own agencies," but instead "are obliged to bolster the justification for increased appropriation requests.").

In its first action on 1952 appropriation bills the House, in March, pared about $40 million from the funds requested for the Treasury and Post Office Departments. In April the House cut by about $100 million the funds asked for the Department of Labor and the Social Security Agency, although the total of $2.6 billion was still $250 million more than they were given this year. The Committee complained that it was hampered in making cuts by statutory pro-

visions for spending beyond its control. Late in April the House cut $666 million or 10 per cent from the appropriations asked for the executive offices and independent agencies.

In the Senate, the Administration's request for $3 billion additional mortgage insuring authority to expand housing in defense areas was cut to $1.5 billion, and numerous safeguards inserted against abuse by private builders and government agencies. A similarly trimmed-down version of the Administration bill has been stalled in the House, awaiting Senate action. While the reduction in requested new mortgage insuring authority does not appear as a budget saving, it limits the creation of additional government contingent liability, and has a direct bearing on the fight against inflation by restricting the demands for mortgage credit.

### *Joint Committee on the Economic Report*

In its report to Congress on April 2, the Joint Congressional Committee on the President's Economic Report, composed of distinguished representatives of both Houses and both parties, stressed the "paramount need for government economy."

The Committee declared that "at some point taxation itself becomes inflationary". For, "if tax burdens are so great as to shock the sense of justice or equality some way is found to avoid them or to pass them on into higher prices."

Recognizing that we must make whatever expenditures are necessary for building a modern and efficient military force, the Committee nevertheless renounced the idea that everything in the defense budget is beyond criticism. "This is no time for luxury, waste, or extravagance anywhere, not even in the armed services." With new obligational authority asked for the military services and international security now estimated to total almost $72 billion for 1952, "all appropriations and expenditures must be subjected to continuous and close scrutiny both by the Executive and by the Congress."

All programs not essential to the defense effort, or to maximum civilian productivity, should, the Committee declared, "be rigorously cut, if not eliminated." It cited with approval an American Farm Bureau Federation recommendation that 1952 agricultural conservation payments to farmers be reduced, and urged reconsideration by Congress of the whole question of farm price supports and other agricultural subsidies.

The Committee suggested also digging into the area of federal grants to the States, carried in the 1952 budget at a total of $2,883,000,000, taking pains to enumerate the principal items as follows:

> Public assistance, $1,300 million; maternal and child welfare, $33.0 million; general and other public health assistance, $31.2 million; vocational rehabilitation, $23.0 million; national school lunch program, $83.5 million; low rent housing, $15.0 million; colleges for agricultural and mechanic arts, $32.0 million; postwar highway construction, $500.0 million; airport construction, $21.0 million; hospital construction, $75.0 million; agricultural extension services, $32.0 million; agricultural experiment stations, $12.0 million.

The general level of these programs, the Committee said, should be reduced.

Regarding further proposals in the President's Economic Report for new federal expenditures for local health services and education – projects dear to the heart of the "welfare-staters" – the Committee had this to say:

> The Government has undertaken so large an armament program, and the prosperity generated thereby has in turn so greatly aided the budgets of various State and local governments, that the traditional methods of financing education and medical aid and public health should again be more fully relied upon.

In the field of defense production, the report dashed cold water on Administration proposals for more funds for loans for expansion of productive capacity and supplies. Such authority, if granted, should, the report said, "be hedged with rigid requirements for vital defense necessity." Both because "this is an effort likely to last for many years," and because "one of the major causes of inflation is excessive credit," the Government "should not embark on an indiscriminate loan program." Moreover, "corporations and others have more liquid funds than ever before." Business, the report pointed out, can secure the equivalent of V loans and procurement advances from the Department of Defense, "techniques which worked with considerable success during World War II." The cases in which additional government money should be lent "should be clearly established."

Nor did the Committee take kindly to the Administration request for legislative authority for direct government construction of industrial facilities. Conceding that such authority might be necessary in an all-out war, the report nevertheless warned that "it handicaps our long-run chances to maintain a maximum of free, private enterprise and reduces our reliance upon the creative impetus of private initiative." Hence the Committee's conclusion – "We recommend against this proposal except in limited fields where clearly demonstrated to be necessary."

### *Other Areas of Possible Savings*

There are other large areas of possible savings in government expenditures. Some of these were

outlined in the recent report of the Committee on Federal Tax Policy entitled "Financing Defense: Can Expenditures be Reduced?", referred to in these columns a month ago.

One of the areas calling for scrutiny is the $7½ billion budgeted expenditures for international aid, including military supplies, in 1952, plus $11 billion of requested new obligational authority. These figures compare with estimated expenditures in this category for fiscal 1951 of around $4.7 billion.

The budget gives few details as to these proposed expenditures. With foreign gold and dollar holdings increasing rapidly in consequence of our aid programs and heavy purchases of raw materials at high prices, there is serious question as to the magnitude of continuing economic aid required. Once again, as in World War II, American dollars are being sprayed to the four corners of the globe. The President, in his budget message, refers to the continuing need of "providing economic assistance to help meet urgent problems in various parts of Southeast Asia." In view of this emphasis on pouring more money into "undeveloped" areas, the following extracts from a despatch to the New York Times of March 27 are of interest:

JESSELTON, NORTH BORNEO, MARCH 26 – The high income from rubber is seriously disturbing the life and economy of North Borneo . . . Production has soared and the income from rubber has more than doubled in the last year. The result for this colony is too much loose money, rising prices, decreased production of other products and accentuation of labor shortage . . .

North Borneo's scanty worker population is deserting other jobs to go to tap rubber. Cooks are abandoning kitchens, clerks shedding their office clothes and rice growers leaving the fields to get a share of the high rubber wages . . . North Borneo tribesmen are at a loss to know what to do with their high rubber wages. Many collect the montly equivalent of $100 to $200 in United States currency – an unheard of sum for a month's work in former days.

The above is not meant to imply blanket condemnation of continuing economic aid for so-called "backward areas". It does emphasize the need for careful discrimination in these programs. Moreover, apart from the merits or demerits of particular projects themselves, there is always the problem of getting practical and competent people to administer them. A danger is in trying to do too much too fast, as witness the following from New York Times correspondent Michael L. Hoffman, appearing in that newspaper on March 25:

GENEVA, MARCH 24 – The United States Government may have been giving Point Four aid to some underdeveloped countries too cheaply.

At least this is the opinion of some of the non-United States officials of international agencies that are actively engaged in technical assistance to backward areas all over the globe . . .

"When we go into some countries with a program and lay down certain things that must be done locally before we will go ahead we often find that we are 'outbid' by the Americans who are willing to give money and aid without laying down any conditions," one such expert said. The "we" in this case is a United Nations agency now engaged in technical assistance work in more than thirty countries.

"This is unfortunate," the expert continued, "because in most cases such aid will be dissipated unless local authorities do adopt appropriate administrative or other changes in order to make it effective.

"Too many Americans go into this thing with the idea that they have to 'sell' technical assistance," another international official observed. "They get so enthusiastic that they want to provide experts and even funds before the groundwork has been done to make the work effective."

All this serves to fortify the impression that the huge sums budgeted for international aid are lavish and should be cut back.

Still other major expenditure items in the 1952 budget include the $4.9 billion listed for veterans, and the $1.5 billion listed for agriculture in a year of high agricultural income. Over $1 billion is budgeted for river and harbor work, reclamation, and public power development, the justification for which should be carefully examined both in the light of defense needs and of whether, in the case of power development, the facilities could be provided by private capital willing and able to do the job if relieved of government interference. Actually, in two notable instances today, the Department of Interior of the Federal Government is contesting the decisions of the Federal Power Commission to license two private utility companies to develop certain hydroelectric projects in Virginia and California because the Interior Department wants to develop them itself with taxpayers' money.

Though President Truman has declared that the Government "must practice rigid economy in its nondefense activities," it is one thing to preach this doctrine and another thing to get it put into practice by the army of officials all down the line who are seldom inclined to view either themselves or any of the operations they supervise as non-essential. A small sample of how "rigid economy" is practiced in some government offices appears in a special study recently released by the Department of Agriculture from which we quote briefly as follows:

Young married men and women have a larger amount of sports and casual clothing in their wardrobes than older people. On the other hand, married men above

forty years of age own more dress hats than younger men and, in addition, have more special outfits for riding, fishing and hunting. The older wives, on their part, own more fur coats, house dresses, and hosiery than the young wives . . .

This edifying disclosure, together with much more along the same line, is, we are informed, the fruit of one of a series of surveys being conducted by the Agriculture Department's Bureau of Human Nutrition and Home Economics. A government really in earnest about reducing non-essential expenditures would be cutting out everything of this kind.

### *Government Lending Operations*

Probably few people in this country realize the vast size and widespread ramifications now reached by the credit and lending operations of the Federal Government. According to a special study appearing in the 1952 Government budget document, the total loans, guarantees and credit commitments by wholly-owned government enterprises will amount to $44.4 billion at the end of the current fiscal year on June 30; and not even this huge total covers everything, since for various reasons it excludes numerous other agencies under government sponsorship, including the Commodity Credit Corporation.

The total, moreover, is on the rise, the June 30, 1951, figure indicating an increase of $9½ billion, or 27 per cent, over the comparable figure last year. By June 30, 1952, a further increase of $4½ billion is expected. This is in a period of mounting inflationary pressures when the authorities are imposing restrictions on numerous types of private lending. The following excerpt from a letter to the editor of the Wall Street Journal from a reader in Havana, Ark., printed in the issue of January 17, gives a homely, grassroots illustration of how government policies are working at cross-purposes:

I am a farmer owning several hundred acres of land and a herd of dairy cattle free of all debt, but when I recently asked my bank for a small short-term loan, I was told that governmental restrictions had curtailed their customer loans. Banks were being required to build up bigger reserves.

But a neighbor, who doesn't own anything but an old car and whose reputation for industry, thrift and prompt payment of his debts is bad, went to a government lending setup and borrowed enough money to buy a small dairy herd – money that my bank had denied me and had put into governmental securities to head off inflation by pinching off my credit.

Apart from the question of the effect of government lending operations upon the budget position and the general credit situation, there is the question of the competence of government in the lending field illustrated by the recent disclosures regarding the R.F.C.

Perhaps it is not too much to hope that Congress will at last put the emphasis in the right place, namely on cutting expenditures to balance the budget and curb inflation, instead of letting the stream of spending go on and then taxing everyone up to the hilt. Cutting expenditures is the only 100 per cent effective anti-inflationary way of balancing the budget. Raising taxes means raising costs, and thus has mixed effects as an anti-inflationary measure.

Of course, the results on cutting expenditures depend on what the legislators in Congress hear from the folks back home, both in terms of pressure for economy and willingness to forego benefits which the people themselves may be receiving. As the policy committee of the United States Chamber of Commerce urged at the annual meeting of the Chamber which began April 30, reducing non-essential government expenditures is a responsibility of both business and individuals alike. Spending can be lightened if the citizens will refrain from seeking government handouts, the committee said, and: "Business should take the lead in promoting a program of self-control".

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